

Euro wrap-up

Overview

- Longer-dated Bunds made gains while German GDP data showed that private consumption contracted in Q3 after the ifo business survey suggested minimal improvement in Q4 to contrast the message of the flash PMIs.
- Gilts outperformed as investors positioned ahead of tomorrow's UK government Budget statement.
- Attention tomorrow will be on Chancellor Reeves' Budget announcements with focus on the total amount, nature, deliverability and timing of the range of fiscal tightening measures planned.

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Daily bond market movements

Bond	Yield	Change
BKO 2 12/27	2.009	+0.002
OBL 2.2 10/30	2.268	-0.008
DBR 2.6 08/35	2.671	-0.019
UKT 3% 03/27	3.747	-0.028
UKT 4% 03/30	3.927	-0.038
UKT 4½ 03/35	4.492	-0.044

*Change from close as at 4:30pm GMT.
Source: Bloomberg

Euro area

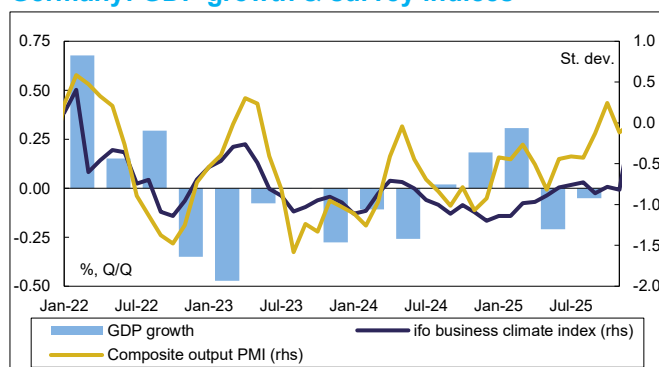
ifo survey contrasts upbeat message about German economic output in middle of Q4

After the German economy stagnated over the summer (see detail below), surveys have provided mixed messages about conditions in Q4. Encouragingly, the flash PMIs point to steady recovery since the summer, perhaps reflecting the boost from increasing public spending and diminished trade-related uncertainties. Indeed, the composite output PMI in November was broadly in line with the long-run average and therefore suggestive of a return to growth this quarter. In contrast, however, the latest ifo survey flagged ongoing challenges, suggesting that the euro area's largest member state remains in the slow lane heading into year-end. According to the ifo institute, firms assessed the current business situation in November to be only marginally better than in October, when the respective index was the weakest for eight months and almost 1½ standard deviations below the long-run average. Moreover, the index was trending some 0.7pt below the Q3 level, suggesting that risks to economic output this quarter are skewed to the downside. And while business expectations for six months ahead remain well up on the range in the first half of the year, firms' optimism about the outlook appeared to stall in the middle of Q4, with the respective index unexpectedly declining 1pt in November. Nevertheless, having reached a more than 3½-year high in October, this still left it trending some ½pt above the Q3 average, raising tentative hopes for a more meaningful recovery in the New Year.

Retailers suffering from weak spending, manufacturing output slips back but services more upbeat

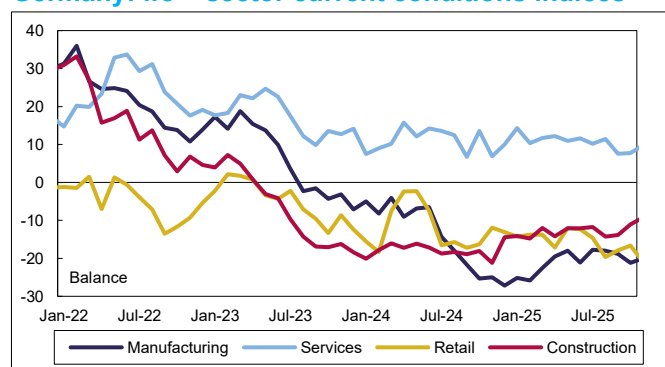
Within the sectoral detail, retailers appeared disappointed by the start of the Christmas season, with the current business situation judged to be the worst since the second Covid-19 wave in early 2021 as households seemingly maintained a preference to save than spend. Manufacturers also reported a weakening in the production trend in November after an early estimate of industrial turnover in October slipped to the lowest level since the first Covid lockdown, some 1½% below the Q3 average. But today's figures showed that the deterioration in the ifo production index in November was led by a substantial decline in the pharmaceuticals and basic metals industries and not broad-based weakening. And on balance, manufacturers still considered demand to be broadly favourable, with overseas orders encouragingly rising to the highest level in 16 months. Inventories were also reportedly the lightest in six months, which should be consistent with rising output in due course. Moreover, while expectations for the coming six months in the manufacturing sector fell back in November, this was down from a 3½-year high in October. And firms in many infrastructure- and defence-related subsectors still see an improving trend over the near term, benefitting from the government's fiscal plans. The services sector should provide some support to growth over the near term too, with firms in hospitality, information services, travel and real estate reporting an improvement in the current situation in November, while expected services turnover in the coming three months was the strongest since June.

Germany: GDP growth & survey indices



Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo – sector current conditions indices

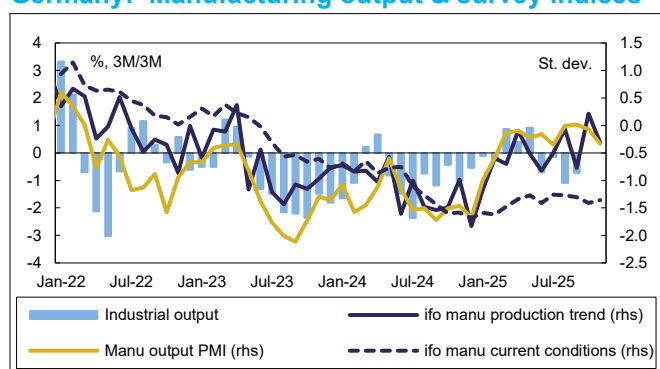


Source: Macrobond and Daiwa Capital Markets Europe Ltd.

GDP flatlined in Q3 on household spending & services export weakness

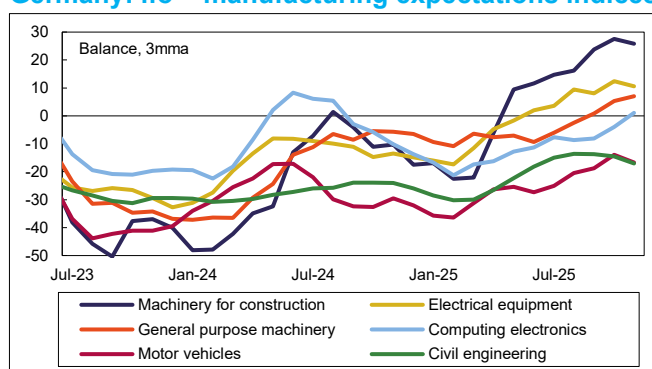
The failure of the ifo current conditions index to improve significantly in Q4 is nevertheless undoubtedly disappointing after GDP contracted in Q2 and flatlined in Q3 to be up just 0.3%Y/Y. Indeed, today's first expenditure breakdown for Q3 confirmed that private consumption contracted for the first quarter since Q423 and by 0.3%Q/Q. That reflected a rise in the household savings ratio to the highest level since end-2024 while real disposable income was unchanged from a year earlier. Fortuitously perhaps, the decline in private consumption was more than offset by an acceleration in government consumption (0.8%Q/Q). Fixed investment also rose in Q3, by 0.3%Q/Q, thanks principally to a pickup in business spending transport equipment. But given the sharp drop in Q2, overall capex was also unchanged on a year-on-year basis. Along with private consumption, the main source of weakness in Q3 was net trade, which subtracted significantly from GDP growth for a second successive quarter and by 0.3ppt. Perhaps reassuringly, goods export volumes fell a minimal 0.1%Q/Q. But services exports fell a steep 2.6%Q/Q due to weakness in licence fee income as well as maintenance and repair services. Total imports were unchanged on the quarter as growth in goods offset similar weakness in services. GDP would have contracted for a second successive quarter had it not been for a second successive quarter of (perhaps involuntary) inventory accumulation.

Germany: Manufacturing output & survey indices



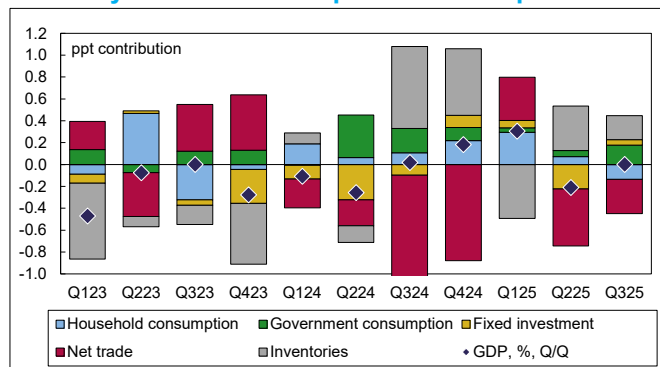
Source: S&P Global, Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: ifo – manufacturing expectations indices



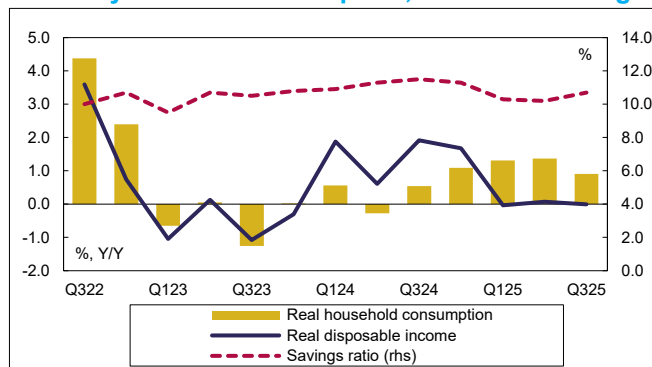
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: GDP & main expenditure components



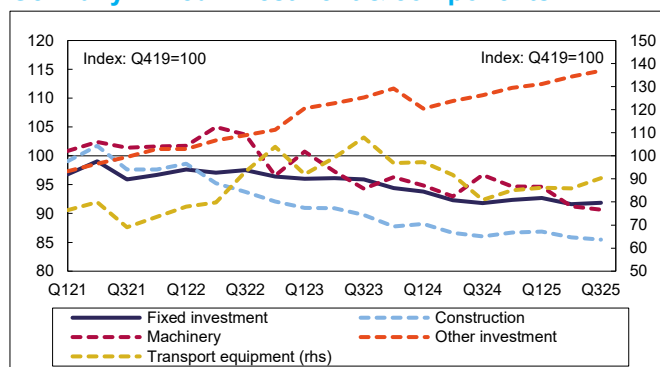
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Private consumption, income & savings



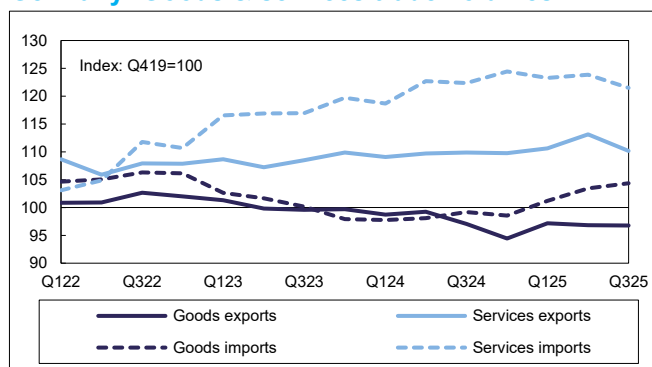
Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Fixed investment & components



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

Germany: Goods & services trade volumes



Source: Macrobond and Daiwa Capital Markets Europe Ltd.

The day ahead in the euro area

Besides the publication of the ECB's biannual Financial Stability Report, it looks set to be a quieter day ahead in the euro area. The economic dataflow will be on pause on Wednesday, with the flow of November's sentiment indices due to resume on Thursday alongside euro area bank lending figures for October.

UK

The day ahead in the UK

UK Chancellor of the Exchequer Rachel Reeves will finally set out the provisions of her Autumn Budget to Parliament on Wednesday. At the very least, the Chancellor's announcements will be expected to draw a line under a period of heightened speculation which has weighed on sentiment and buffeted the gilt market in recent months. But as detailed in Friday's [Euro wrap-up](#), the government's current borrowing trajectory looks to be out of line with its fiscal rules. And to restore compliance, the Chancellor will need to tighten fiscal policy, which most estimates predict will amount to a not insignificant £30bn in FY29/30. That partly reflects the past policy U-turns for disability benefits eligibility and pensioners' winter fuel payments, as well as the need to create space for new policies, among others removing the two-child benefit cap. The Chancellor is also expected to raise her fiscal 'headroom' – to a more conservative level of (at least) £15bn by FY29/30, from £9.9bn in last year's Budget – to minimise the chances of further speculation and another damaging fiscal tightening in a year's time. But the single largest contributor to that shortfall will be the expected downgrade to the OBR's forecast assumption for productivity growth.

Cuts to day-to-day government spending are likely to make up only a fraction of the shortfall. So, higher taxes are expected to do most of the heavy lifting. Contrasting their earlier signals, the government will not look to target any of the three 'big' revenue-raisers – which would have constituted a manifesto breach – although the freeze on income tax thresholds will be extended to FY29/30, from FY27/28, raising a little over £10bn. Otherwise, a series of smaller tax measures are set to be tapped. As front-run by media outlets, changes to the terms of salary sacrifice pension schemes, a form of council tax surcharge on more valuable homes and tax rises on gambling firms are teed up. Inevitably, there might also be changes to the detail for inheritance and capital gains taxes. Banks, however, look set to avoid being singled out for a windfall tax while a 3-year stamp duty holiday will be offered on trades of shares of firms newly listed on the London Stock Exchange. Small amounts of revenue will be raised from token measures such as extending the sugar tax to milk-based drinks. A pay-per-mile charge for EVs is also a possibility, albeit with rumours that the Budget will allocate additional spending to the Government's EV subsidy scheme. Separately, plans to reduce the cash ISA limit by 40% (to £12k) – designed to direct savings towards UK-listed equities – would likely have a neutral fiscal impact.

Given the relatively greater uncertainty about the extent of revenues that might be raised via such a piecemeal approach, the tax rises should ideally be introduced sooner rather than later. Alongside an ample increase in fiscal headroom, that might provide more reassurance to market participants about the government's commitment to fiscal sustainability. Nevertheless, gilt issuance next fiscal year is expected to rise from a touch under £300bn in FY25/26 to somewhere between £305-315bn. However, Chancellor Reeves has also signalled that she will steer clear of potentially inflation-stoking measures. Indeed, the Budget is likely to include provisions targeting the cost of living – with measures to reduce electricity bills touted and the fuel duty freeze inevitably to be extended – which together with a substantive net fiscal tightening over the monetary policy horizon centred on the household should support the case for a pre-Christmas rate cut by the BoE.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Euro area	 New car registrations Y/Y%	Oct	5.4	-	9.0	-
Germany	 GDP – final estimate Q/Q% (Y/Y%)	Q3	0.0 (0.3)	<u>0.0 (0.3)</u>	-0.2 (-0.1)	-
	 GDP – private consumption Q/Q%	Q3	-0.3	-	0.1	0.2
	 GDP – government spending Q/Q%	Q3	0.8	-	0.8	0.2
	 GDP – capital investment Q/Q%	Q3	0.3	-	-1.4	-1.1
France	 INSEE consumer confidence indicator	Nov	89	90	90	-
Spain	 PPI Y/Y%	Oct	0.7	-	0.3	-
UK	 CBI distributive trades survey – reported retail sales % balance	Nov	-32	-30	-27	-

Auctions

Country	Auction
Germany	 sold €3.044bn of 2.2% 2030 bonds at an average yield of 2.27%
Italy	 sold €2bn of 2.1% 2027 bonds at an average yield of 2.18%
	 sold €1bn of 1.1% 2031 inflation-linked bonds at an average yield of 1.08%
	 sold €1.5bn of 2.4% 2039 inflation-linked bonds at an average yield of 2%
UK	 sold £4.5bn of 4.125% 2031 bonds at an average yield of 4.088%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Monday's results

Economic data

Country	Release	Period	Actual	Market consensus/ <i>Daiwa forecast</i>	Previous	Revised
Germany	 ifo business climate indicator	Nov	88.1	88.5	88.4	-
	 ifo current assessment (expectations) indicator	Nov	85.6 (90.6)	85.5 (91.6)	85.3 (91.6)	-

Auctions

Country	Auction
- Nothing to report -	

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country	GMT	Release	Period	Market consensus/ <i>Daiwa forecast</i>	Previous
- Nothing scheduled -					

Auctions and events

Euro area		09.00	ECB to publish Financial Stability Review		
Germany		10.30	Auction: to sell up to €3bn of 2.6% 2035 bonds		
UK		12.30	Chancellor of the Exchequer Reeves to present UK Budget to Parliament		

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Access our research blog at:

<https://www.uk.daiwacm.com/ficc-research/recent-blogs>

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